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Retaining Bush Tax Cuts Necessary to Keep Economy Rolling

by Jack Kemp
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Former Clinton Treasury Secretary Robert Rubin, writing in the New York Times recently, makes the case for fiscal austerity when he insists taxes must be raised or deficits will cause the economy to crumble. Using static revenue estimates from the congressional Joint Committee on Taxation, which ignore the effect of tax rates on economic growth, the left claims the Bush tax cuts will "cost" the federal government $2 trillion during the next decade, and deficits will soar. Few serious economists believe raising tax rates on work, saving and investment will strengthen the economy. What Rubin and his colleagues on the left leave out of the equation is the fact that if the economy doesn't grow - and it won't grow if we repeal the Bush tax cuts - the deficit will only get bigger.

President George W. Bush in 2003 signed into law the Jobs and Growth Tax Relief Act aimed at restoring the economy to health after having suffered through three years of recession and sluggish recovery caused, in large part, by the Fed's deflationary monetary policy and high tax rates. The Bush tax cuts of 2003, among other things, reduced the tax rates on capital gains and dividends to 15 percent, accelerated scheduled reductions in individual income tax rates and increased the amount of capital investment that small businesses could write off ("expense") in the year in which they made investments as well as providing "bonus" depreciation for all businesses to invest in equipment and leasehold improvements.

After growing at a meager average quarterly rate of 1.4 percent a year since the third quarter of 2000, the economy took off subsequent to the Bush tax cuts and has averaged annually adjusted growth of more than 4 percent since then. There is no doubt the Bush tax cuts worked as advertised to restore the U.S. economy to health. Rather than repealing them, Congress should get about the business of reforming the tax code by adopting something along the lines of what Steve Forbes recommends - giving everyone five years to choose between filing returns under a 20-percent flat tax or under the current tax code, after which the current code would be repealed altogether. Wow! What a prospect for the American people.

By slashing the tax on corporate dividends, Bush focused squarely on the task of forming new capital by raising shareholder value and boosting the stock market. The result: the Dow has jumped about 2000 points, or 22 percent, over the past two years, and the tech-heavy NASDAQ has gained more than 35 percent. And the tax cuts did more than breathe life back into stock markets.

A recent study by the Cato Institute found that in the first year after the Bush tax cuts, dividends increased by an aggregate of more than $60 billion, and a 25-year decline in S&P 500 companies paying dividends was sharply reversed. More recent data from the American Shareholders Association shows that, for the first time since the 1980s, the number of companies paying a dividend increased for three consecutive years. ASA also finds that personal dividend income has increased by $100 billion since the tax cuts. But ASA's most significant finding is that, for the first time in decades, earnings growth is correlating with dividend growth.

The economy and the stock market weren't the only things the Bush tax rate reductions restored to health; they also revived federal revenues and will reduce the budget deficit by some $60 billion from last year's level. As the Wall Street Journal pointed out last week, "So far this year federal tax revenues are booming. Overall, in the first seven months of Fiscal Year 2005 through April 30, they climbed by $146 billion to a total of $1.216 trillion. That's an increase of 13.6 percent over a year earlier, some four or five times the inflation rate, and the kind of raise that most American families can only dream about."

It would be a shame and a tragedy to allow these tax cuts to expire as the law currently provides. Unfortunately, in order to avoid a filibuster in the Senate, Congress was forced to make the tax cuts temporary. Consequently, all of the Bush tax cuts are set to sunset sometime between the end of 2004 and 2008. The capital gains and dividends tax cuts will expire at the end of 2008. The small-business first-year expensing provision and the so-called "bonus" depreciation provision that allowed companies a special credit for investment in equipment and leasehold improvements both expired at the beginning of this year.

These incentives to work, save and invest lit the fuse on economic recovery and already one can see evidence that their expiration could snuff it out. Since the first-year expensing and depreciation provisions expired five months ago, investment in new plant and equipment has taken a nose dive. Between the second quarter of 2001 and the first quarter of 2003, private domestic investment in equipment and software averaged a negative 4.7 percent a year - our capital stock was shrinking. After the Bush first-year expensing and bonus depreciation provisions were enacted into law, the rate of investment in equipment and software jumped to 13.6 percent a year until the first quarter of this year after the provisions expired, when it fell to an annually adjusted rate of 5.6 percent a year.

Congress should immediately make the Bush tax cuts permanent, including the death tax which is scheduled to repeal in 2010 but than comes back to life like a vampire the next year. If Senate Democrats play around stalling extension of the tax cuts, threaten a filibuster on them too and try to play class warfare games in the mid-term elections next year, they will be playing with fire. Refusing to extend the tax cuts could reverse the economic expansion, slow down job growth and stifle small business creation. That would be the real "nuclear option."

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